

#### **D. COLLECTING FUNDS**

This section addresses the issue of how to structure a fund to pay for the programs identified in the previous section. In defining the funding mechanism, we answer a number of the remaining questions that the Commission posed, above all, question 10.

**10. HOW SHOULD TELECOMMUNICATIONS PROVIDERS BE ASSESSED FOR FUNDING A UNIVERSALS SERVICE SUPPORT MECHANISM AS THE USF? HOW SHOULD UNIVERSAL SERVICE SUPPORT ASSESSMENTS BE STRUCTURED TO ENSURE THAT THE LEVEL OF ASSESSMENT AND THE SERVICES TO WHICH IT WILL APPLY ARE APPROPRIATE FOR ALL TELECOMMUNICATIONS PROVIDERS? WHAT SPECIFIC INFORMATION WOULD BE NEEDED TO CALCULATE THE ASSESSMENT? IN WHAT SPECIFIC WAYS SHOULD THE ASSESSMENT CHANGE FROM CURRENT PRACTICES? SHOULD THE COMMISSION REQUEST ADDITIONAL AUTHORITY FROM THE LEGISLATURE TO EFFECT THIS CHANGE?**

Funding for universal service should be based on the value of telecommunications services delivered by service providers. That is the best measure of the benefit extracted from the ubiquitous telecommunications network. The rate of assessment (i.e. the tax rate) should be uniform across all types of service. To the extent that specific types of service generate less value in the marketplace, they will bear a smaller part of the burden.

Contributions should be based on the net telecommunications revenue of the service provider in the state. Net revenues are calculated as total telecommunications revenue earned in the state net of payments made to other telecommunications service providers in the state.

It is important to base the calculation on net revenues to identify the value being added and the resources being extracted by the individual service providers in the state. Gross revenue approaches count intra-industry transfers twice (once on the books of the seller of the input and once on the books of the seller of the final service). When companies merely pass through large

amounts of expenses incurred through the purchase of underlying telecommunications services from other providers, they are not adding that value to the network. To the extent that they are profiting from the use of those services, that will be reflected in the difference between what they pay at wholesale and get at retail.

In essence the assessment rate for the universal service fund should be calculated as the total amount needed divided by the net value of telecommunications services sold in the state.

For telecommunications service providers, the intra-industry transfers are easy to calculate and audit -- they appear on the books of each company as either an expense or income.

All classes of contributors should contribute at the same rate. Using the net revenue approach reduces arguments over the type of services rendered to their underlying value to the public and presumably the companies.

The state must set up an accounting system to identify net telecommunications revenues for these providers. Reporting and paying to the universal service fund should be a requirement in the certification process. The system already established for the Telecommunications Infrastructure Fund at the Comptroller's office could be expanded to include the universal service fund.

All telecommunications service providers should make a direct contribution to the fund. They benefit from the ubiquity of telephone service and they should help to support it. Further, by assessing the service providers, they will have the opportunity to decide how to recover those costs. Some providers may choose to absorb those costs out of corporate profits. Others may roll the costs into monthly billing rates.

We believe that Section 254(f) of the Act which reserves the rights of the states to establish intrastate funded universal service programs requires the inclusion of all intrastate telecommunications services in the base of funding for the program. We also believe that it precludes the use of line item surcharges on consumers' bills. The fund raising mechanism at the federal level cannot be a line item on the customer's bill and the fund raising mechanism at the state level should not be such. PURA 95 calls for the assessment to fall on telecommunications service providers. These entities may seek to recover that assessment in a variety of ways.

Thus, the answer to the Commission's seventh question is no.

**7. SHOULD A CONTRIBUTION FOR UNIVERSAL SERVICE BE LABELED EXPLICITLY ON CONSUMERS' BILLS, AS A "CHARGE TO SUBSIDIZE HIGH COST SERVICE" ON THE PAYERS' BILLS AND A "SUBSIDY TO UNDERWRITE HIGH COST SERVICE" ON THE RECIPIENT'S BILLS?**

## **IX. ACHIEVING UNIVERSAL SERVICE UNDER FEDERAL AND TEXAS LAW**

The previous sections have defined a comprehensive policy for preserving the progress that has been made toward universal service and further advancing the state toward the ultimate goal of meeting the needs of all its citizens for telecommunications services at rates that are just, reasonable and affordable. We have answered about half of the questions posed by the Commission, including all of the substantive questions about goals and programs. The remainder of the questions deal with how policies and programs to achieve universal service fit under PURA and the new federal law.

Those questions are taken up in this section.

## **A. AN OVERVIEW OF PURA95 AND UNIVERSAL SERVICE**

### **1. BASIC SERVICE: ADEQUATE AND EFFICIENT SERVICE AT JUST, REASONABLE, FAIR AND AFFORDABLE RATES**

Section 3.002(1)(H) leaves the definition of basic service open to Commission interpretation. Although a list of services is specified as a minimum, the Commission has the authority to expand the list if that would further the goal of universal service to include "any other service the commission, after hearing, determines should be included in basic local telecommunications service."

At the same time, the Texas law embodies precisely the principles that have been articulated in the federal law. Section 3.051(b) requires rates to be just, fair, and reasonable while service is adequate and efficient.

We suggest that the use of the word fair is entirely consistent with the federal language that requires basic service to bear "at most a reasonable share of joint and common costs." Since basic service for residential ratepayers is the least likely to be competitive and universal service is a primary goal of both federal and state law, fairness requires this recovery of joint and common costs from these services at only at reasonable levels.

### **2. GENERAL RATE REBALANCING**

Efforts to broadly and radically rebalance rates as proposed at the federal level and in other states are foreclosed to electing telecommunications carriers and would require precisely the types of economic and cost analyses proposed in the discussion of rebalancing.

Not only must rates be just, fair reasonable and affordable, with service adequate and efficient, but there is extensive language in the law to prevent cross subsidy of competitive services.

Section 3.051(g) contains broad prohibitions against rates that "(1) unreasonably preferential, prejudicial, or discriminatory; (2) subsidized either directly or indirectly by regulated monopoly services; or (3) predatory or anticompetitive." This language is consistent with our view of the loop as a joint and common facility whose costs must be recovered from all services which use the loop. To allow services to use facilities for free would be unreasonably preferential, discriminatory and anticompetitive.

The only federal policies which can be identified as demanding state rate changes for rates generally are those which affect the separations process. These are to be addressed under PURA 95 Section 3.002(10). Separations involves the division of costs between the federal and state jurisdiction. If federal actions raise or lower the amount of separated costs in the state jurisdiction, then only the aggregate changes in the separated costs can be addressed under this section (and Section 3.353, which sets a minimum level of impact). If federal policy does not affect the separation of costs between the federal jurisdiction and the state jurisdiction, it does not require state action under this section of the law.

### **3. RATE REBALANCING AND ELECTING COMPANIES**

For electing companies the barriers to rate rebalancing are even more clear. Basic rates cannot be raised for 42 months (Section 3.353). Access charges for long distance companies cannot be lowered (Section 3.352). This is the core of the proposal to rebalance rates. These changes are simply unavailable to electing companies. When those rates are subject to review, such a review would be comprehensive and include precisely the types of analyses that we have suggested in earlier sections of these comments.

Even after 42 months, the review and rebalancing of rates under this section must take into account "changed market conditions and the effects of competitive entry." New market opportunities are certainly part of the changed market conditions. For non-electing companies, there are specific guidelines which will govern any rebalancing of rates.

#### **4. UNIVERSAL SERVICE FUNDING**

The universal service funding language in Section 3.608 addresses a very different issue than broad-based rate rebalancing. This section deals with changes in specific funds which have been established to lower costs in high cost areas, to support services for consumers with disabilities, and provide discounts to low income households. These specific programs are readily identifiable in current practice and subject to the specific details of regulatory actions, as described below in response to the Commission's questions, only specific changes in funding for these programs can be addressed under this section of the law.

#### **B. ANSWERS TO COMMISSION QUESTIONS ABOUT THE LEGAL STATUS OF UNIVERSAL SERVICE**

**QUESTION 9. SHOULD THE COMMISSION REVISE ITS UNIVERSAL SERVICE SUPPORT MECHANISM RULES AND PROCEDURES IN THE NEAR FUTURE, OR WAIT UNTIL THE FEDERAL GOVERNMENT RESOLVES ALL FEDERAL TELECOMMUNICATIONS ACT UNIVERSAL SERVICE IMPLEMENTATION ISSUES BEFORE CHANGING TEXAS' UNIVERSAL SERVICE PROVISIONS?**

The Commission should wait for the outcome of the federal universal service and local competition proceedings. This will enable the Commission to have both the final federal universal service funding changes before it, as well as some initial evidence on the impact of

competition. As described throughout these comments, the impact of both of these processes on the LECs is unclear at present. However, we recommend PURA be amended to give the PUC the authority to develop a universal service program in response to the federal proceedings. Otherwise, Texas would have to wait until after the 1999 Legislative session to develop a universal service program.

**QUESTION 11. IF BROAD CHANGES ARE NEEDED TO THE WORKINGS OF THE STRUCTURE OF TEXAS'S UNIVERSAL SERVICE SUPPORT MECHANISMS, WOULD IT BE HELPFUL TO INITIATE SOME FORM OF MECHANISM DURING THE TRANSITION FROM THE CURRENT METHOD TO A NEW METHOD OF UNIVERSAL SERVICE FUNDING? IF YES, WHAT MIGHT SUCH A TRANSITION MECHANISM LOOK LIKE? HOW LONG MIGHT BE NEEDED (I.E. HOW LONG WOULD THE TRANSITION PERIOD BE)?**

The Commission should not attempt to guess what the impact of competition will be. It should not assume that revenue streams which are to be exposed to competition will change quickly or dramatically. Competition is likely to be quite slow to unfold because of the deeply entrenched nature of the local monopoly. Furthermore, revenue stimulation for the incumbent companies is likely to result from the introduction of competition, as well as from the movement into new services and markets. The Commission cannot possibly guess the direction or order of magnitude of the net effect of these complex forces.

The one major change in the approach to the USF being recommended in these responses is in the shift from a funding mechanism that targets only intrastate minutes of use to a

mechanism that targets net telecommunications revenue. This change does not require a transition period, but a period to develop the accounting and auditing methodologies.

Also, the self-certification for the Lifeline program described in Section VII.B. could be implemented immediately.

**QUESTION 12. WHAT OTHER IMPACT MIGHT THE FEDERAL TELECOMMUNICATIONS ACT HAVE ON TEXAS' UNIVERSAL SERVICE FUND?**

It is impossible to predict the impact of the diverse forces unleashed by the Telecommunications Act on Texas' universal service fund.

On the one hand, we might see a dramatic reduction in the demands on the universal service fund:

- Competition may dramatically lower the cost of telecommunications services, reducing the need for a universal service fund.
- Revenue opportunities may dramatically improve the financial conditions of local exchange carriers.
- The Federal Communications Commission may put some costs now allocated to the state or regulated jurisdiction into the federal or unregulated jurisdiction. This would lower the costs allocated to the state jurisdiction and ultimately to basic local service.

On the other hand, we may see that substantial pressures placed on universal service in selected areas. We might observe:

- selective competition for high margin services which reduces revenues for local exchange companies and
- federal decisions that shift costs onto local service ratepayers and into the state jurisdiction.

It is crucial for the Commission not to make major changes in rate structure or public policy before the impact of competition can actually be discerned in the marketplace. Above



all, proposals to engage in radical rate rebalancing or to institute regulatory indemnification plans should be rejected.

There is no reason to believe that changes in market structure and revenue stream will be large or rapid. The entry of competitors into local markets is likely to unfold quite slowly. Changes in market share move almost glacially in the telecommunications industry. Further, as noted above, local companies have compensating opportunities which will generate revenue streams that support much of the telecommunications plant. Both the rate rebalancing and the stranded investment arguments should be rejected.

The LECs complain about rate patterns which recover differential contributions to joint and common costs from different services and classes of customers. They then hypothesize the business strategy by which new entrants would compete away the high contribution business. This view of competition is very much the monopolist's zero-sum view of the world. As the LECs portray it, there is a predefined amount of business, all of which is, will and should belong to the monopolist. They seek protection against competitive loss of that business and indemnification against the financial consequences of any such losses before competition is even allowed to exist.

The projections of future revenue losses or expectations about further underperformance of assets, for which the companies want to be indemnified is based on erroneous assumptions. Competition is not the zero-sum game the LECs make it out to be. Markets expand through innovation and creativity. Average costs decline as volumes grow in an industry with high fixed costs and long lived asset, like telecommunications. Securing the LEC revenue stream against competition as they demand will overcharge the public and undermine competition.

The LEC proposals also do not recognize or admit the demand stimulation that will result from rebalancing. By shifting costs away from higher elasticity services (which also furthers their competitive strategies) they end up with higher aggregate demand for all services and higher revenue streams. Their approach fails to take these changes into account. The result is both higher profits and a stronger position vis-a-vis competitors, at the expense of ratepayers.

**QUESTION 13. WHAT INFORMATION IS NEEDED FOR THE COMMISSION TO DETERMINE WHETHER A COMMISSION ORDER, RULE OR POLICY HAS CHANGED OR WILL CHANGE THE "AMOUNT OF HIGH COST ASSISTANCE FUND? [SECTION 3.608(b)(2)]**

The Commission requires information on both the supply-side and the demand-side impacts of its actions in order to make a reasonable projection of the revenue effect of the action. If the action is associated with a reduction in costs or prices, such actions can be reasonably expected to stimulate demand, which automatically increases revenues.

**QUESTION 14. IS THE COMMISSION REQUIRED TO ACT ON THE BASIS OF PROSPECTIVE ESTIMATES OF REVENUE REDUCTION OR INCREASE IN COSTS RESULTING FROM ITS DECISIONS OR ONLY ONCE ACTUAL USE REVENUES FOR A GIVEN COMPANY OR FOR THE FUND AS A WHOLE HAVE BEEN REDUCED? WHAT PROCEDURAL MECHANISM SHOULD THE COMMISSION USE TO REPLACE THE REASONABLY PROJECTED REDUCTION IN REVENUES CAUSED BY A PUC ORDER, RULE OF POLICY [SECTION 3.608(b)(2),(3),(4),(5)]**

A reasonable projection of revenue impacts cannot be a simple arithmetic calculation. Complex supply-side and demand-side forces that will flow from such Commission actions must

be taken into account. If the legislature had intended for the Commission to simply do the arithmetic, it would not have charged the Commission with making a reasonable projection of the revenue effect.

Therefore, the Commission should act on the basis of evidence from the actual experience under its actions, rather than pure projections. For example, the Commission could conduct proceedings to be completed within 90 days of the end of the fiscal year within which an action was taken.

Such an approach is consistent with normal administrative practice and the language of PURA 95 in general. From the point of view of administrative efficiency, this estimation of revenue effects would also be conducted simultaneously with the other calculations (the assessment rate for collection, the draw for other targeted programs, etc.) and estimations that are necessary under other sections of the PURA 95.

To the extent that a company can demonstrate unique adverse effects associated with a scheduled process for estimation of its draw from the fund, it should be allowed to do so.

**QUESTION 15. WHAT GUIDELINES SHOULD BE ESTABLISHED TO REVIEW A COMPANY'S PROJECTED REDUCTION IN REVENUES OR INCREASE IN COSTS IN ORDER TO DETERMINE THAT THE REDUCTION IS REASONABLY PROJECTED? WHAT GUIDELINES SHOULD APPLY TO REVIEW PROJECTED REDUCTIONS IN REVENUES AFFECTING THE HIGH COST ASSISTANCE FUND? [SECTION 3.608(b)(2),(3),(4),(5)]**

The Commission should consider the underlying rationale for the order which is alleged to be having the revenue effect and the overall effect of the order.

- Does the change in revenue reflect assumed or documented changes in costs and to what extent are these changes in costs reflected in rates?
- Does the order reflect changes in prices that flow automatically to customers? If so, what effect will this change in prices have on demand and consequently, revenue?

Let us take the example of the introduction of 1 + intraLATA competition, introduced under the federal policy of linking intraLATA to interLATA competition. Since the action will, of necessity link the two changes together, reasonably projected reductions in contribution must take both changes into account -- i.e. the reduction in intraLATA contribution and the increase in interLATA contribution. Further, in order to reasonably estimate the change in contribution, the Commission must take into account reasonably projected changes in demand resulting from the introduction of competition.

**QUESTION 16. WHAT MECHANISM SHOULD BE USED TO REPLACE THE REASONABLY PROJECTED CHANGE IN REVENUES CAUSED BY AN FCC ORDER, RULE, OR POLICY WHICH REDUCES THE COMPANY'S REVENUES? IF THE CHANGE INCREASES RATHER THAN DECREASES THE COMPANY'S REVENUES, IS THE COMMISSION ALLOWED TO RESTORE THE REVENUES TO THE ORIGINAL, LOWER LEVEL? [SECTION 3.608(b)(3)]**

The LEC's draw from the Texas universal service fund should be increase or decreased to reflect the reasonably projected impact of the FCC order. Of course, if the Commission had previously allowed rate increases, then policies resulting in increased revenue should result in rate decreases.

**QUESTION 17. WHAT IS MEANT BY THE TERM "ADVERSELY IMPACT" UNIVERSAL SERVICE IN SECTION 3.608(b)(4) OF PURA 95? WHAT MEASURES COULD BE USED TO DETERMINE WHETHER AN ADVERSE IMPACT WILL OCCUR?**

Following from the definition of affordable service provided in response to question 2, "adversely impact" means either an increase in the burden associated with basic service that causes serious inconvenience or detriment or a decrease in the penetration rate.

**QUESTION 18. REFERENCING SECTIONS 3.608(b)(3),(4),(5) OF PURA 95. "... THE COMMISSION SHALL IMPLEMENT A MECHANISM THROUGH EITHER THE UNIVERSAL SERVICE FUND OR AN INCREASE IN RATES....," WHAT RATES SHOULD BE INCREASED?**

Since universal service is identified as the burden associated with basic rates and the percentage of households that take basic service, the most direct manner in which to prevent adverse impact, while replacing reasonably projected reductions in revenue should be to raise the assessment for the universal service fund. The Commission should not raise rates. To the extent that the Commission decides that rate increases are necessary, rates for non-basic services should be increased, not rates for basic service.

**QUESTION 20. REFERENCING SECTION 3.608(b)(6) "THOSE DISBURSEMENTS SHALL BE IMPLEMENTED PROMPTLY AND EFFICIENTLY SO THAT TELECOMMUNICATIONS PROVIDERS AND LECS DO NOT EXPERIENCE UNNECESSARY CASH FLOW CHANGES AS A RESULT OF THESE CHANGES IN GOVERNMENTAL POLICY," WHAT IS MEANT BY THE WORDS "PROMPTLY AND**

**EFFICIENTLY"? WHAT IS AN "UNNECESSARY CASH FLOW CHANGE", AND HOW IS IT DISTINGUISHABLE FROM A NECESSARY CHANGE IN CASH FLOW? IF THE CHANGE IS CAUSED BY A CHANGE IN GOVERNMENTAL POLICY, IS IT A NECESSARY CHANGE?**

As discussed above, it seems reasonable to conduct a universal service proceeding on a year to year basis. A number of actions associated with the universal service fund will be necessary on that basis (calculating assessment rates and the draw for other targeted programs, etc.).

**QUESTION 22. REFERENCING SECTION 3.608(d)(2), HOW WOULD THE COMMISSION DETERMINE THAT THE LECs MEET THE MINIMUM REQUIREMENT OF OFFERING SERVICE TO EVERY CONSUMER WITHIN ITS CERTIFIED AREAS? WHAT DOES IT MEAN TO "OFFER SERVICE" IN A COMPETITIVE ENVIRONMENT?**

For purposes of drawing support from the USF in high cost areas, the offer of service means that the provider is shouldering the responsibility for the facilities necessary to deliver service to that customer and meeting the Commission's quality of service rules. Any carrier offering service and meeting quality of service standards should be able to draw for support of discounted rates for low income and disability programs.

**QUESTION 23. IT APPEARS THAT AS SECTION 3.608(d)(2) IS WRITTEN, IF A LEC IS IN COMPLIANCE WITH THE COMMISSION'S QUALITY OF SERVICE REQUIREMENTS THEN THE LEC IS PROVIDING ADEQUATE SERVICE WITHIN THE AREA? IS THIS A CORRECT INTERPRETATION?**

Yes, see above.

**QUESTION 24. THE TEXAS EXCHANGE CARRIER ASSOCIATION (TECA) IS CURRENTLY THE ADMINISTRATOR OF THE UNIVERSAL SERVICE FUND (USF). AS A RESULT OF CHANGES IN THE UNIVERSAL SERVICE FUND BY THE PUBLIC UTILITY REGULATORY ACT OF 1995, PLEASE COMMENT ON WHETHER TECA SHOULD CONTINUE TO BE THE ADMINISTRATOR OF THE USF?**

We believe an independent body must be charged with administering the fund.

**QUESTION 25. UNDER WHAT CIRCUMSTANCES SHOULD TELECOMMUNICATIONS PROVIDERS OTHER THAN LECS BE ABLE TO SEEK REIMBURSEMENT FROM THE PURA95 USF? DOES THE FEDERAL ACT CHANGE THE CIRCUMSTANCES UNDER WHICH LECS MAY RECEIVE REIMBURSEMENTS? IF SO, PLEASE EXPLAIN HOW.**

New entrants who serve consumers who are the recipients of discounted rates -- low income, consumers with disabilities -- should be allowed to draw from the universal service fund. They should receive reimbursement for the discounts.

To the extent that entrant are certified as carriers of last resort as described above, they should receive high cost assistance.

**C. QUESTIONS TO WHICH THE COMMENTORS HAVE NO RESPONSES**

5. HOW MUCH MONEY IS NOW COLLECTED FROM TEXAS TELECOMMUNICATIONS CONSUMERS FOR THE FEDERAL AND STATE UNIVERSAL SERVICE FUNDS (AND SPECIFICALLY, FROM WHICH COMPANIES, IN WHAT AMOUNTS, THROUGH WHICH RATE ELEMENTS, TO WHICH FUNDS)? HOW MUCH IS PAID BACK TO TEXAS TELECOMMUNICATIONS PROVIDERS FROM THE TWO FUNDS (SPECIFICALLY, TO WHICH PROVIDERS FROM WHICH FUNDS, IN WHAT AMOUNTS)? IS CURRENT INFORMATION AVAILABLE TO ANSWER THESE QUESTIONS? IF NOT, HOW CAN THE COMMISSION COLLECT THIS INFORMATION EFFICIENTLY AND EXPEDITIOUSLY?

19. REFERENCING SECTION 3.608(b)(4), PLEASE SUGGEST POSSIBLE SCENARIOS WHICH COULD REQUIRE AN AFFECTED COMPANY TO EITHER SEEK COMPENSATION FROM THE USF OR INCREASE RATES.

26. WHAT SECTIONS OF THE COMMISSION'S SUBSTANTIVE RULE SECTION 23.53 SHOULD BE MODIFIED TO CONFORM TO PURA 95?

Respectfully submitted,



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